RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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May 18, 1988 **LETTER 991**

May 6 DJIA 2007.46; PTI 2696; A-D Ratio -9.26
May 13 DJIA 1990.55; PTI 2696; A-D Ratio -9.62
Current Dow Yield: 3.60%; Dow P/E: 15.0
Dow 200-day mov aver: 2143; DowPow: 653

BEAR MARKET DIARY: May 6: The **PTI** violates its rising trendline, a trendline which has held since the December 4 low (see page 2 chart). May 9: The **advance-decline ratio** breaks under its April 4 low, dropping to its lowest level since February 12 (page 2 chart). May 11: The **Dow** drops through its important March 30 low of 1978.12. On the same day the **Transports** confirm by breaking below their April 20 low of 827.36. The simultaneous downside penetrations give the market an ominously bearish appearance. With the Dow now 140 points below its 1988 high, there is a strong probability that the post-crash recovery is history.

THE MARKET: Pre-election years, historically, have been good years for the stock market. Furthermore, years ending in "5" and "8" have historically been the strongest years in the well-known decennial pattern. Yet here we are in 1988 (both an 8 year and a pre-election year), and the 1988 performance can hardly be termed a strong one. What's happening? In my opinion, the poor market performance so far in 1988 is simply a testament to the strength of the bear. This bear market couldn't care less about election years or decennial patterns. It's out to mangle investors, and it's out to manufacture losses.

Seven months have elapsed since the Great Crash, and for the last seven months the Dow has been holding consistently below its 200-day moving average. I consider the Dow's position below its MA to be bearish. I also consider the time factor of this negative relationship (seven months) to be bearish.

A further technical consideration is that the Dow has never, since its crash low of 1738.84, been able to recoup so much as 50% of its bear market losses. The bear market losses are the losses figured from the 2722.42 Dow high of August 25, 1987 to the 1738.84 low of last October 19. That loss amounts to 984 points, so the halfway or 50% Dow level is 2230. In seven months of trying, the Dow has been unable to advance anywhere near the halfway or 2230 level. I also consider this action (based on the 50% Principle) to be bearish.

Do you get the feeling that for the last seven months the bear has been playing with the optimists and those who have been buying all these "bear market bargains"? Consider this: On October 21, 1987 (only two days after the crash) the Dow closed at 2027.85. On the same day the S&P 500 closed at 258.38. As of this writing (close to seven months after the crash) the Dow and the S&P 500 are well below the levels recorded two days after the crash.

You see, that's how the bear works. You read the newspapers or the brokerage publications or your neighbor's favorite market advisory. And they tell you how good business is, and they tell you about all those stock bargains. So you buy a few stocks and wait, hoping those stocks will go higher. But the bear market works against you, and once four or five months go by -- you're in the hole and losing sleep and praying that somehow you'll get your money back.

In recent Letters I've stated that we always give the prevailing primary trend (in the current case the bear trend) the benefit of the doubt. On that basis, I stated that we should regard the recent highs in the Averages as the peaks for 1988. Those highs were Dow 2110.08 (April 12) and Transports at 904.12 (March 23). The Utility Average topped out way back on January 29 at 190.02.

As of now I would consider the post-crash rally to be over -- unless the Industrials and the Tranports can better those highs. If the post-crash rally is over, then the next important move will be a testing (and probable breaking) of the 1987 crash low. But remember this -- there's no time table for the testing of the crash lows. The test can begin now or six months from now.

Bear Market Note: Market volume has simmered down considerably, and I want to remind subscribers that (unlike the situation in a bull market) in a bear market a dull volume area is usually bearish -- it signifies a drying up of buying power. Thus a dull volume area in a bear market is often the prelude to a fall. And that's exactly what we saw prior and during last week's drop.

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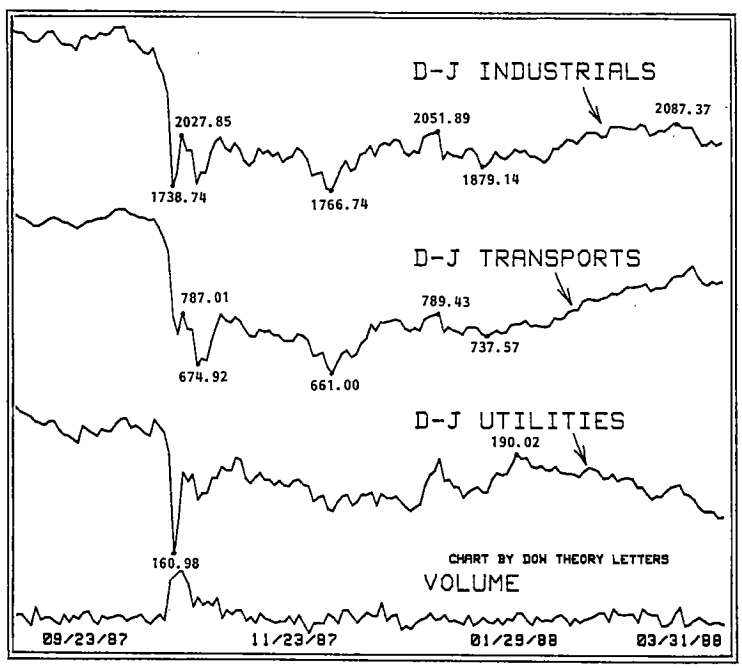
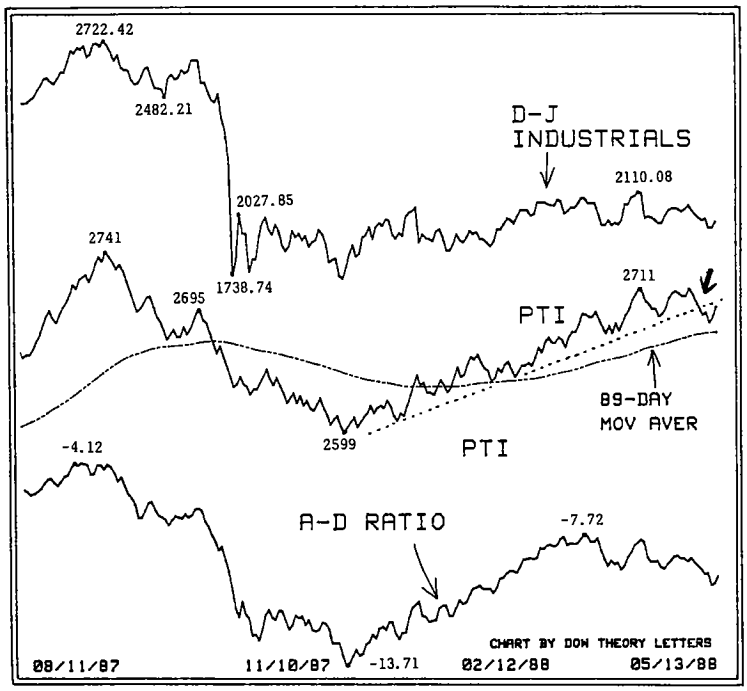
Subscribers may wonder why I have been spending so much time in Letter after Letter warning about holding stocks, warning about trading stocks, warning about playing the switch fund game. The answer is that I want my subscribers to realize that the tidal force of a bear market will ultimately part you from your bank account. Mess with the bear long enough and you're going to end up a loser. I've lived through a number of bear markets, I've seen hundreds of players try to beat the bear. Few succeed. Nine out of 10 leave poorer (but unfortunately, not always wiser).

THE BIG PICTURE: The bear loves it. The bear sits back and watches the US deficits mount, watches America's leading corporations being taken over by foreigners, watches the dollar struggle to hold its own, watches interest rates push higher. The bear loves it. And the bear's in no hurry -- no hurry at all.

Question -- How do you keep the good times rolling when you don't turn out products that are salable on world markets? Answer





-- you depreciate your currency so that it takes fewer dollars to buy your products. Ah, but there's a catch. When you depreciate your currency, you're not just offering your merchandise at bargain prices, you're putting the store up for sale.

And in time, the buyers (your creditors) will own you. In the case of the US, our foreign creditors will own us in two different ways. The first way is that they'll literally buy us and own us. For instance, Britain's Beazer is currently fighting to take over Koppers, the big US supplier of building materials. Canada's Robert Campeau has just bought mighty Federated Dept. Stores (so long, Bloomingdale's). Britain's Marks and Spencer now owns dear old Brooks Bros. Japan's Bridgestone has devoured Firestone Tire and Rubber. Hawaii's major hotels are being taken over one by one by the Japanese. Forty percent of LA's downtown commercial buildings is owned by the Japanese. Need I go on?

The second way our creditors will own us is as follows: The US is running a deficit which the Conference Board now estimates at $180 billion for 1989. This means that the federal government is spending $3.46 billion a week (that's right, a week) more than it takes in. How can they do it? The US does it partly by selling its debt (bonds, bills) to foreigners, partly by the Fed buying up the remaining paper. But since we depend heavily on foreigners to keep the party going, we have, in effect, given our foreign creditors the power.

The Japanese people are savers, and they are workaholics. For years Japan has produced more than it consumes. The US is a different animal. For years the US has consumed more than it produces. Therein lies the problem. The problem is chronically unbalanced national accounts. And that means that one way or another, the US will have to become more like Japan. (Even, by the way, as Japan is becoming more like the US.) That, in a nutshell, is what this bear market is all about. The bear market is about the coming "belt tightening" and lowered standard of living in the US -- plus the need for US industry to turn fiercely competitive again -- with or without a cheaper dollar.

If you can add 2 and 2 and get 4, you know that it's utterly impossible for the US government to continue to spend $3.45 billion every week above what it takes in. Something has to give. Up to this point, what has given is the dollar. But the dollar's decline alone is not going to solve the problem. Remember, foreigners now holds tens of billions of dollars. And as the dollar weakens our creditors will demand higher interest rates for buying and holding dollar debt.

As interest rates rise, the US economy will be squeezed. At which point the bear will come out of his lair and the real trouble will begin. That, in my opinion, is what we will be looking forward to in the months ahead. But looking out even further, we will witness a bloated nation being forced to attack its budget deficits. We will witness an over-leveraged economy facing austerity. We will witness a nation heavily in debt facing "the big squeeze," the squeeze being what we've avoided for so long -- recession (or worse).

Because we have depended on the kindness of foreign creditors for our continuing "prosperity," the credit markets have become the dog that wags the market tail. When you talk about credit, you're talking about bonds. Bonds are now the Big Kahuna, the seven foot Watusi, the Mega-monster that moves and controls the markets.

Because the credit markets are so huge (they absolutely dwarf the equity markets), it is on the credit areas that interest will center as this bear market moves on. The major questions will be -- how can we halt the rise in debt, how can we control the debt so that the debt doesn't control us (which of course it will), and how can we ever get out from under the debt monster? Finally, and this is a "biggie," what happens to the US economy (which has been living on debt) when the debt is finally cut back?

Remember this and remember it well -- you can slash your expenses, you can change accountants, you can renegotiate your rent, you can lay off your workers, you can order salary cuts across the board from the president of the company to the janitor -- but you must pay the interest on your debt. It is estimated that there is now roughly $10 trillion in total debt in the US. At a 7% average interest rate, $700 billion a year in interest payments is required to service the debt. With that kind of total interest, you are talking about major trouble in the next recession. And I mean MAJOR. And that's why the bear is smiling. He's patient, he's nasty, he's ruthless, and he's biding his time. Remember the old Rolling Stones hit song, "Time is on my Side." Today, that's the theme song of the bear.

COMMENT: I believe (and I've stated it here before) that the *Wall Street Journal* " blew it" by ignoring technical market factors all these years. The *Journal* has always disliked technical analysis (believe it or not, the *Journal* still will not accept investment advisory advertisements). But with the emergence and wide acceptance of technical analysis, the *Journal* was backed against the wall. *Investor's Daily* came out with its many pages of technical data. Other newspapers began carrying technical data. So the *Journal* was finally forced to revise its market pages, and today the *Journal* does carry a bit more market information.

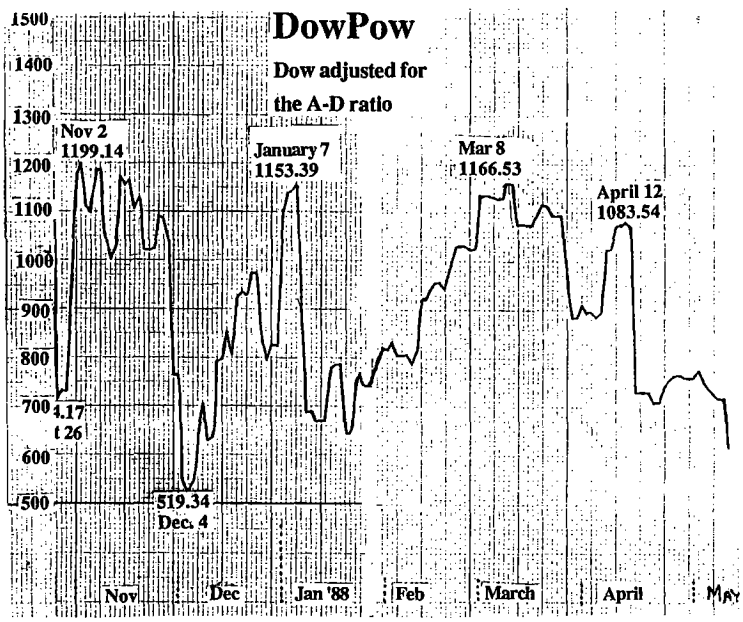
Over the last few weeks the *New York Times* has moved further into the technical data and chart picture. Now the *Times* publishes the put/call ratio, a daily chart of "the Dow minute by minute," investment comparison charts, charts of the major averages, yield tables, etc. All very impressive.

The battle for market coverage is on. What will this do for (or against) technical analysis? The old market adage states that "news known is news discounted." I think the adage will apply increasingly to the field of technical analysis. I believe that many of the widely-followed technical items published in the *Times, the Journal, Investor's Daily* and *USA Today* will lose much of their value.

Conclusion: I will be depending more and more on my proprietary indicators, the PTI and DowPow -- plus my own intuition. Furthermore, the big picture (i.e., the fact that we are in a primary bear market) will loom increasingly important while the various widely-followed technical studies (all geared to the near-term) will become less important. Result: Investors and traders will (unfortunately) probably focus increasingly on the daily-published technical gadgets and gizmos and less on the big picture. In the end the bear will have his way and the concentration on the short-term technical items will prove to have been pretty much a waste of time.

INVESTMENT POSITION: The bear remains in the box. The public and most professionals are thoroughly confused by the bear market, and aside from gambling on takeovers and mergers, they have been doing little or nothing. As I have said repeatedly, this bear market promises to be a long one and a very difficult and deceptive one. We are still in the first phase of the bear market. This is the phase where stocks go down for no apparent reason, or at least no reason that is obvious in the business picture.

In the second phase stocks decline as they react to actual and very visible deteriorating business conditions. I would expect the second phase of this bear market to begin within three to six months. In the meantime, take all those optimistic business forecasts with a grain of salt. The market can look further ahead than the staffs of *Fortune, Business Week, The WSJ,* and *Forbes* taken together. And according to Dow's Theory, the market does not like what it sees. Consequently, you stay on the sidelines.



DOWPOW: You think it's easy staying steadfastly bearish when everyone is telling you that "the bear market is over?" Believe me, it's not. And gad, am I thankful for DowPow. That little indicator has kept me out of a lot of trouble here in 1988. While takeovers, leveraged buyouts, and mergers were painting the NYSE tape, DowPow was persistent in saying that the post-crash rally was "a nothing, a washout."

Since its October 21 post-crash high, DowPow has recorded a series of declining tops. As this is written, DowPow is within shooting distance of its December 4 low of 519.34. As I interpret it, DowPow is telling us that the market's strength is slowly ebbing. And it won't take much selling to send DowPow to new lows. If that happens, I would expect 85% of the 1988 stock purchases to move into the loss column. A DowPow break below 519.34 would be a signal that the bear is coming out of his lair -- after his seven months of hibernation.

LOOKING BACK: I spent most of last weekend re-reading my own and George Schaefer's reports, reports written during the period of 1966 to 1974 (Schaefer was the great Dow Theorist of the 1940s to '70s.) That was a difficult bear period, believe me. It was particularly difficult because all during that period the government fought the bear. And in those days (with considerably less US debt and a very positive trade balance), the Fed could exert an enormous bullish influence -- despite the fact that the primary trend was down.

Here's what happened (and it almost drove Schaefer and me up the wall). Following the 1966 bull market top (Dow 995), the bear took over and smashed the market down to a late '66 low (Dow 744). The counter-bear forces then ran the market up to a fantastically speculative 1968 high (Dow "double top" at 985). The bear took over again, driving the market down to a crushing mid-1970 low (Dow 631). Again the counter-bear forces rallied the market to a January 1973 high (Dow at all-time high of 1051, but the Transports failed by a wide margin to confirm -- as did the breadth).

At that point the market was totally exhausted (so were Schaefer and I) , and the bear decided to take his revenge on Wall Street and the nation. The market went into a prolonged and sickening collapse, a cave-in that didn't end until December 1974 (Dow 577).

Looking back on that period, this is the way I see it -- following the 1966 bull market peak, we went through eight years of distribution, speculation, government manipulations, rallies, and declines. But in the end the bear had his way as he always does, and the market was decimated in the worst smash (1973-74) since the 1930s.

And I wonder, what are we in for this time -- in this bear market? Obviously, I don't have the answer. Except that I doubt very much that this bear market is going to resemble 1966-74 or 1929-32 or 1937-42. This bear market is going to be its own animal, and its going to have its own character.

I've lived through bear markets before, and I have no doubt that I'll make it through this one. What am I looking for? For one thing, we're going into a bear market with a terribly over-leveraged economy, an economy heavy with junk bonds, debt-laden corporations and consumers with little or no savings. (Savings? Face it, consumers are mired in debt.) Furthermore, we're going into a bear market in which the prices of many "things" (houses, art, collectibles, jewelry, etc.) are at sky-high levels.

We haven't really had a full-fledged price collapse since the '30s, and I wonder if this bear market might not bring on a national (even international) price collapse. That would be something new for Americans. It would be an unbelievable shocker.

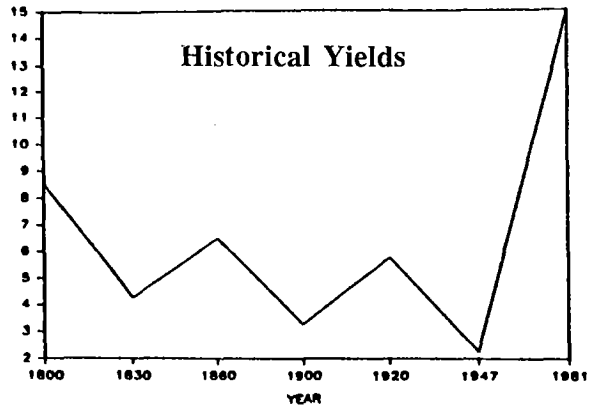
But the truth is that I really don't know what to expect during this bear market. I hope it's a much shorter bear market than the eight years of 1966-74. I hope it's much milder than 1929-32. I hope it's a lot easier than 1937-42. I have a lot of hopes, but I know one thing. I'll do my best to get my subscribers though the bear market whole and in one piece. In the end, as my dear old dad told me so many times, "All you've got is what's between your two ears." So why worry? I'll just do my best and take things as they come.

INTEREST RATES: This is undoubtedly one of the most important charts of the year. Unlike cycles in the stock market, cycles in interest rates tend to last for decades. This chart is courtesy of *Investor's Digest* of Canada. It shows the very broad trend of interest rates for the entire period from 1799 to 1981.

What we see here is that the average duration of the interest rate cycle has been roughly 29 years. The evidence so far indicates strongly that the latest interest rate cycle peaked at its high end in 1980-- at a time when long-term US government bond yields surged to near 15%.

Since then we have seen rates on the long T-bonds drop to single digit numbers. Here is my thinking about what will happen from this point on. Somewhere ahead -- it may be in 1989 or 1990 -- the US is going to experience a recession, very probably a severe recession. The US has never gone through a recession with anything like the amount of debt it is burdened with today, so when this recession hits it's going to contain some surprises.

When the recession hits I expect an almost unprecedented amount of debt-distress. I also expect that there will be an acute need for



cash, cash simply to allow many banks and non-financial corporations to keep afloat. There will also be a lot of dumping of medium and lower grade debt in favor of the highest grade debt. The sudden need for cash and liquidity plus the jettisoning of lower grade bonds could bring on an interest rate spike.

That spike could represent the last surge into double digit interest rates. The spike would be accompanied by severe economic distress and a multitude of major and minor bankruptcies. If so, the whole situation will prove to be traumatic for American businessmen (many of whom have allowed their corporate structures to become ridiculously top-heavy with debt).

The aftermath of such a traumatic situation will, I feel, be a long period of fiscal conservatism. Debt will once again become a dirty word, and the new philosophy in all walks of American life will be "get rid of your debt, get conservative, get solvent." When this happens we could see an extended period in which debt is reduced in all sectors of this nation. At the same time, interest rates will come down. But rates won't come down in one fell swoop. If history repeats, we could see a period of perhaps a few decades when rates come down in a long, tedious, very irregular pattern. But they will come down.

CHARTS: Whenever I read a longwinded commentary on trends or an opinion on why the market has to do this or that, I silently think to myself, "Give me charts, let me see the price action, and spare me the talk. One picture is worth a thousand words, and one chart is worth a three-hour dissertation."

As veteran subscribers know, I like semi-logarithmic charts, charts that show moves in terms of percentages. All price movements on semi-log charts can be correctly compared, since all price action is shown in percentages.

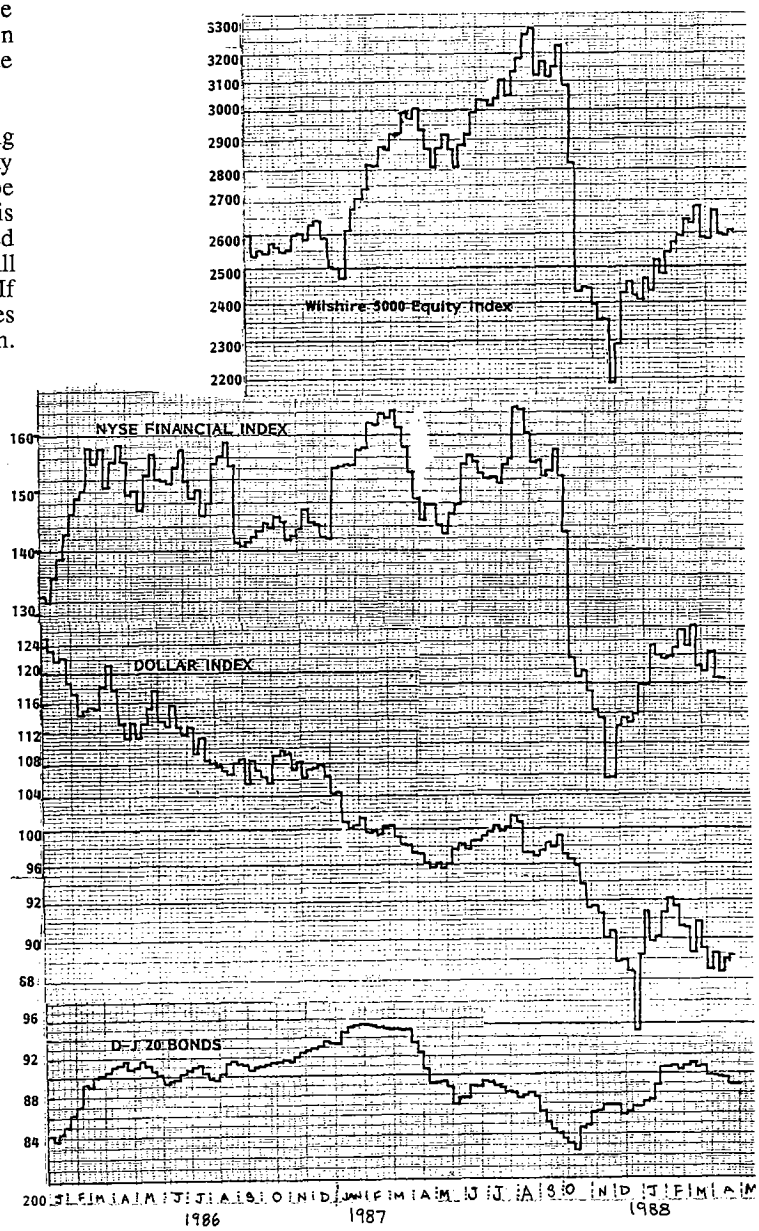
I include a few of my (currently) more interesting weekly graphs. First we see the very comprehensive Wilshire 5,000 Index. This index shows the value of 5,000 stocks (all NYSE and Amex issues plus many OTC issues) in terms of dollars. The Wilshire is considered a good gauge of the value of US stocks in general. The Wilshire hit its high last August at a value of $3.299 trillion. At the crash low the Wilshire was at $2.310 trillion, showing a bear market loss of $989 billion or very close to $1 trillion. It is estimated that foreign markets lost another $1 trillion. The latest figures show the Wilshire at aound $2.6 trillion, still FAR from its 1987 high.

I follow the NYSE Financial Index closely. I do so because it's an important index, an index which includes all the NYSE financial issues such as banks, S&Ls, small loan companies, brokerage houses, insurance companies, etc. The picture here is self-explanatory. The financials took a terrible beating during October through December and the recovery has been minimal. The chart suggests that "financial America" is still in trouble.

The dollar index consists of 11 major foreign currencies, but the index is heavily weighted for the yen and the mark. You can see that the dollar has been on a "greased slide" for years. The December downside spike took the dollar into oversold territory,and it has been bouncing around ever since. However, the December low has held. The chart tells me that the dollar has not reversed to the upside yet, even though it recovered some since the lows. If the dollar index rallies above 92 I'll be impressed. A strong move about 92 would tell me that we were witnessing an important reversal in strength of the dollar. But relax -- it hasn't happened yet. (Note: It is estimated that our trading partners spent $1 billion last year supporting the dollar. How long can that go on?)

In view of the abysmal action of the dollar, the bonds have really not acted half bad. The D-J 20 Bond Average topped out last year at just under 96. In October the bonds plunged to 83. A major advance from the October lows took the 20 Bonds to just over 91. At present the 20 Bonds are in the 88-89 area. As I said, the bonds don't act too badly. In view of the dollar and the budget deficits, they actually act better than I thought they would.

NOTES & QUOTES: Dept. of Little Known Facts: It looks like an all-Ivy-League battle coming up in November. What battle? Michael Dukakis (Harvard '60) vs. George Bush (Yale '48). According to Nixon, to win the presidency a Democrat has to be a "love the people" type such as a John Kennedy or a Hubert



Humphrey. Nixon opines that Dukakis is "too cerebral" to be a proper Demo candidate. Nixon could be right. Russell opinion: If the bear holds off until after election, Bush will probabably take it. If the bear goes on a tear again before election, Bush could be in real trouble. Worse, if the bear strikes before election time the market will see Dukakis as a potential winner, and that fear will intensify any bear market action as market pessimism feeds on itself (Wall Street has always been afraid of the "tax-and-spend" Democrats). Of course, the only difference between the two parties is that the Republicans "borrow and spend."

With Iran-gate, the continuing "kiss and tell" revelations, the Meese mess, and now the astrology revelations, Reagan is coming across to the public as a sort of "senile, passive, amiable boob." This is creating a problem for Bush, who is faced with a dilemma. Should he or shouldn't he distance himself from Reagan? I believe he should.

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No one knows the size of the so-called "underground" or "shadow" economy, but by all estimates it is huge. The *Survey of Current Business* gives a conservative estimate that the underground economy is roughly 4% of GNP. On this basis, figuring the GNP at $4.488 trillion, the underground totals an annual $179 billion. However, most scholars believe that the underground economy is nearer 10% of GNP and on this basis we're talking about an economy near half a trillion dollars.

What does the underground economy consist of? Services and swaps between people, unreported cash sales, gambling money, dope money, contract killing money, prostitution, smuggling, loan sharking, swap meet transactions, garage sales, on and on. Experts now believe that growth in the underground economy is stronger than that of the regular or reported ecomomy.

Who's most interested in the underground economy? The IRS, of course. The agency feels that it is missing at least $100 billion annually in taxes from all those unreported transactions.

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The unnerving title of a book just published -- "The Second Wave: Japan's Global Assault on Financial Services" by R.W. Wright and G.A. Pauli. The book tells the story of the world's most regulated but richest pool of capital, the Japanese money mountain.

My actress daughter, Betsy, has just returned from nine days in Japan. Here are a few of Betsy's observations. Breakfast for two in Tokyo — $50. Hotel rooms are small. In the cheaper hotels, they are tiny. Tokyo is super-crowded, space is at a huge premium. Land and housing prices out of sight. Everyone smokes. People are extremely polite. The Japanese are very proud of their possessions -- she didn't see a single dirty car in Tokyo. Good looking Americans create a minor sensation. The young Japanese are much taller than their parents. Red meat and fast food is becoming a part of the Japanese diet. Betsy said she had never eaten so much rice in her life.

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From our "Action Speaks Louder Than Words" Dept:
Do they like San Diego? The Marines know the town via Camp Pendleton. The Sailors know SD because it's Pacific Fleet headquarters. The guys and gals see SD and then return. The latest figures show that 266,000 US military veterans now reside in San Diego. That's a quarter of the city's population!

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The prices being set at the big New York auctions are bordering (in my humble opinion) on insanity. On May 2 a new record was set for contemporary art. A Jackson Pollack painting ("Search" painted in 1955) went to a Japanese dealer for a fat $4.8 million (the same painting went for $2.57 last year). Sotheby's expected the auction of Warhol's huge mountain of collectibles to net $10 to $15 million. Final tally was over $25 million. One dealer noted that a crystal he had sold to Warhol for $300 went for $10,000. At an earlier auction a huge D color internally flawless diamond sold at the highest per-carat price in history -- an unbelievable $140,000 per carat. Then last week a 37" Degas sculpture went at Sotheby's for an astounding $10.1 million. A Renoir went for $8.8 million. A Matisse went for $5.7 million. A Cezanne sold for $9.2 million. The art world is leaving reality far, far behind.

And then we have diamonds -- this is from the industry's authoritative *Rapaport Report* (April 29): "Here in the US we are stuck with the dollar. As the dollar gets weaker, so do we. The US has lost significant purchasing power to the Japanese. We are now second class buyers in the diamond markets. In the old days Japan only bought top qualities, leaving everything else for the US buyers. But now Japan and the Far East buy everything. Japanese 1987 imports from Israel and India are up 70% and 65%. As the Far East buys a broader range of goods we are left with an ever decreasing supply of leftovers. Already major US retailers are scrounging for average-grade goods only to find that Hong Kong buyers have already made off with the goods. The US is reacting too slowly. By the time the average US retailer wakes up, he will be unable to buy suitable goods at the price customers want. The US is going to have to sell lower quality goods at higher prices. The recent De Beers price increase is not hype. They are going to radically change the diamond business in the US. Wake up America!"

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The states are beginning to feel a budget pinch, or should I say a squeeze. After posting a $1 billion surplus last year (which they passed out to taxpayers), California reported a $1 billion tax shortfall this year. Not to be outdone, New York state reported a $500 million tax receipt shortfall for the single month of April. According to the *NY Times*, "Indeed, Mr. Cuomo, who until this year has consistently underestimated revenues, said himself last month that he wished he had proposed lower spending." Since both states must by law balance their budgets, we can expect services to be cut and quite soon.

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It is generally conceded that both Russia and the US have passed their peaks of power. The US's peak of power was probably established around the end of World War II at which time the US was supreme both economically and militarily. No other nation even came close. Russia may have hit its peak of power around 1957 when (I remember it well) Sputnik shocked the world and the US space program was seen to be well behind the Russians.

Times have changed. Russia's economy is now in the doldrums and Gorbachev is trying mightily to turn around a nation that is passive, inefficient, crippled with bureaucracy and basically living in the past (and lacking any great wish to change). The US is mired in debt and deficits and consistently consumes more than it produces. The US growth rate is now dropping far behind Japan and the "tigers" of the Far East (S. Korea, Hong Kong, Taiwan). Many are talking about the coming years as "the Asian Century."

Russia's Gorbachev sees the problem, and he is grappling with the Russian bureaucracy, trying to change the sodden Russian picture. But the entrenched Russian leaders are putting up a wall of resistance. Russia's passive, sluggish population is paralyzed by the miasma of the communist system.

The place to look is China. China is still back in the dark ages, but with China (unlike Russia) you are dealing with a population of 1 billion workaholics, all toiling for minuscule wages. Furthermore, China is moving toward capitalism or at least toward the profit system. And (are you ready for this?), China will open five futures markets in Canton this fall. Russell opinion -- Watch China, an emerging giant. Watch the US and Russian military. Military costs are bankrupting both nations and leaving them far behind in the battle for world markets. The military in both Russia and the US will have to be cut drastically.

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Tax reform? Lower taxes? The Tax Foundation Inc. states that the average American paid 34.5% of his income to taxes this year vs. 34% last year. Next year (Russell opinion) taxes are guaranteed to go up.

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The bear market is having its effect on the major stock exchanges. The first four months of 1988 show Amex's volume down 28%

from the same months in 1987, Pacific Stock Exchange is down 27%, NASDAQ is down 15.6%, while the NYSE is doing best -- down 6%.

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Harley Davidson is celebrating is 85th year in business with a fantastic gala reunion to benefit MDA. From dozens of cities in the US and Canada, Harley cycle riders will head for the company's headquarters in Milwaukee. The ride starts on June 10 and ends on June 18 in time for the Harley birthday party. Expected number of bikes heading for Milwaukee -- 10,000. I'd love to go, but they won't close the NYSE for me, so I'll have to stay in La Jolla. But can you imagine the sight and the sound -- 10,000 Harleys!

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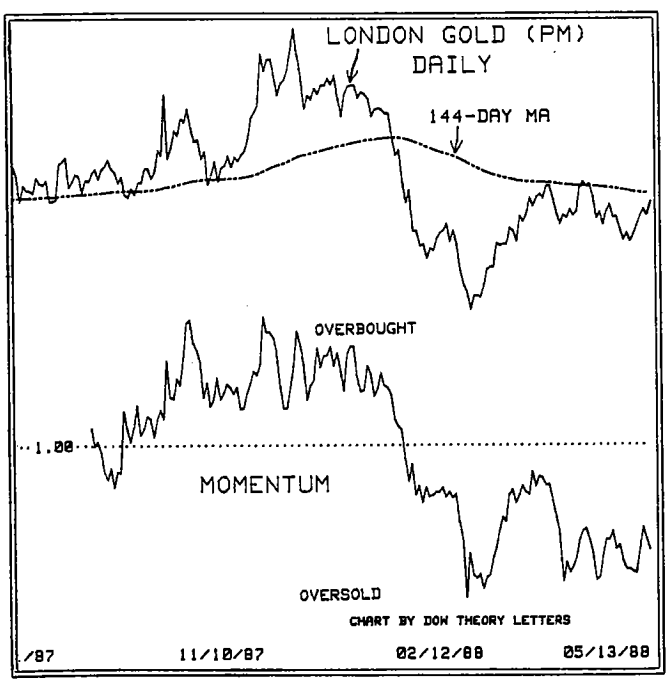
Note: Because of the Memorial day holiday, the next Letter will be mailed out one day late on Thursday, June 2.

GOLD: As veteran subscribers know, I attach a good deal of importance to the gold/common stock ratio. The ratio is simply the price of gold divided by the NYSE Composite. When the ratio is rising (in favor of gold) I consider this to constitute a fundamentally bullish background for the yellow metal. A rising gold/common stock ratio does not necesssarily mean that gold is in a bull market, but on the other hand I have learned to distrust any rise in gold that is not accompanied by a rising gold/common stock ratio.

What is the ratio doing now? Few people realize it, but the gold/common stock ratio hit its 1988 low on February 29, 1988 at **282.** Since then the ratio has been slowly but steadily rising (in favor of gold) -- to its recent level (May 12) of **314.** To put it in simpler terms, since February 29 of this year gold has been outperforming common stocks.

If there's a recognizable long-term cycle pattern or price periodicity in gold, it would appear to be a 5-1/2-year or a 66-month cycle. This 66-month cycle hit lows 1973, in mid 1976, in late 1978, in early 1982, and in early 1985. It's entirely possible that last February's low gold fix of 423 represented the latest 66-month cycle low. That possibility is heightened by the fact that the gold/common stock ratio hit its 1988 low the same month -- February 29. The probability of a February low is further bolstered by the current skepticism and bearishness toward gold. Many gold commentators are now openly predicting that gold will test or break 400 in the period ahead with some precious metal bears even talking about $300 gold.



Personally, I don't see gold testing 400 or even breaking its February low. Admittedly, the "feeling" in the air today is that gold is probably going nowhere, but if it is heading anywhere, the direction is down. But that's the kind of sentiment that is often associated with base building, and that's my guess -- that gold is in a base-building mode today.

Turning to my gold chart, note that gold is holding just below its 144-day exponential moving average -- which now stands at 455. Thus any rise in the London fix above 455 would constitute a bullish plus for the metal. Furthermore, the position of the momentum index on the chart indicates that gold is quite oversold and could be ready to make the journey up into neutral and then overbought territory.

LATE NOTES: First, bonds. I feel (despite what you may be hearing) that bonds are acting quite well in today's market. True, due to inflation fears and continuing good business statistics, the long-term Treasury bonds have moved up into the 9.15% to 9.25% yield area. However, one thing I watch carefully is a comparison of the futures contract for muni bonds with the T-bonds. And I note that on the recent downside break when the June T-bond slipped under 88, the muni bond contract did not confirm. In the past, a downside non-confirmation between these two bond contracts has been a sign of strength. A second indication -- I haven't been offered any attractive (high-yield) munis lately. For instance, there haven't been any California GOs offered near 8%. My perception is that despite widespread talk of bond weakness, nobody's been dumping any bonds. In fact, I get the feeling that there has been a lot of informed buying of bonds over the past few months.

Stocks: In last Sunday's *New York Times* business section the front page story was, "The Death of Investor Confidence -- Little Appetite for Stocks." In a poll of 750 households the *Times* found that only 3.5% now plan to buy stocks, as against 35% last August. The Times blamed the reluctance on "fear of being whipsawed by program trading." But last week five major brokerage houses stated that they would cease program trading. Will that restore confidence? Don't bet on it.

Of course, the real culprit, the real confidence killer, is the bear market on Wall Street. It's the bear market that nobody want to admit exists. But the bear is there, the bear caused the crash, and the same bear is preventing stock profits from building up. And unhappily, I must report that the bear is fated to be around for quite some time.

What about the near term picture? For me, the features of the past couple of weeks have been (1) my PTI breaking its rising trendline, which, of course, is a negative for the market, and (2) DowPow sinking to within shooting distance of its December 4 low. Both of these are indicative of market deterioration. More emphatic deterioration would be evidenced (1) if the PTI were to break below its 89-day moving average, and (2) if DowPow were to violate its December 4 low.

In breaking below signifcant previous lows last week, The D-J Industrial and Transportation Averages indicated that the secondary trend of the market is now down. The question is -- will the market continue the mild downside momentum set off by the break in the Averages or will bear market boredom and tediousness continue to rule Wall Street? It may be that we will have to move nearer to election time before the market does anything of a decisive or dramatic nature. In the meantime, patience and caution continue to be the order of the day. Remember, this bear is extremely patient — and we had better be too.

Late, late note: as this is written (May 16) commodities have turned very strong almost across the board. Grains are sharply higher, platinum is up near 10 dollars. Gold on the June contract is up to 457, and it looks very much as if inflation is heating up (if only short-term). The pressure is now on for a discount rate rise, and Wall Street is wondering how much longer the Fed can hold off (they're holding off for political reasons, obviously).